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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY
FOR A HEARING TO DETERMINE THE
FAIR VALUE OF THE UTILITY PROPERTY
OF THE COMPANY FOR RATEMAKING
PURPOSES, TO FIX A JUST AND
REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP
SUCH RETURN, AND TO AMEND
DECISION NO. 67744

Docket No. E-01345A-05-0816

IN THE MATTER OF THE INQUIRY INTO
THE FREQUENCY OF UNPLANNED
OUTAGES DURING 2005 AT PALO VERDE
NUCLEAR GENERATING STATION, THE
CAUSES OF THE OUTAGES, THE
PROCUREMENT OF REPLACEMENT
POWER AND THE IMPACT OF THE
OUTAGES ON ARIZONA PUBLIC SERVICE
COMPANY'S CUSTOMERS.

Docket No. E-01345A-05-0826

IN THE MATTER OF THE AUDIT OF THE
FUEL AND PURCHASED POWER
PRACTICES AND COSTS OF THE
ARIZONA PUBLIC SERVICE COMPANY.

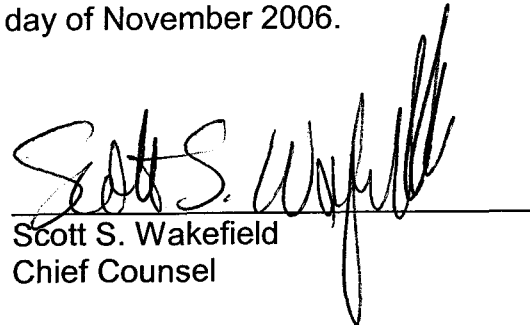
Docket No. E-01345A-05-0827<

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the
Testimony Summaries of J. Richard Hornby and David A. Schlissel in the above-referenced
matter. Confidential material has been redacted from the testimony summary of Mr. Schlissel

1 that is being filed with Docket Control. The confidential portion of his testimony summary is
2 being lodged under seal with the Hearing Division, and is available to parties that have entered
3 Protective Agreements with APS by contacting RUCO's counsel.

4
5 RESPECTFULLY SUBMITTED this 3rd day of November 2006.

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8 
Scott S. Wakefield
Chief Counsel

9
10 AN ORIGINAL AND SEVENTEEN COPIES
11 of the foregoing filed this 3rd day
12 of November 2006 with:

13 Docket Control
14 Arizona Corporation Commission
15 1200 West Washington
16 Phoenix, Arizona 85007

17 COPIES of the foregoing hand delivered/
18 mailed or *emailed this 3rd day of November 2006 to:

19 *Lyn Farmer
20 Chief Administrative Law Judge
21 Hearing Division
22 Arizona Corporation Commission
23 1200 West Washington
24 Phoenix, Arizona 85007

*Christopher Kempley, Chief Counsel
Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

*Ernest Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

*Thomas L. Mumaw
*Karilee S. Ramaley
Pinnacle West Capital Corporation
Law Department
P. O. Box 53999
Mail Station 8695
Phoenix, Arizona 85072-3999

*Deborah R. Scott
Kimberly A. Grouse
Snell & Wilmer L.L.P.
400 East Van Buren
Phoenix, Arizona 85004-2202

1 *Barbara Klemstine
 *Brian Brumfield
 2 Arizona Public Service
 P. O. Box 53999
 3 Mail Station 9708
 Phoenix, Arizona 85072-3999
 4
 *Bill Murphy
 5 Murphy Consulting
 5401 N. 25th Street
 6 Phoenix, Arizona 85016
 7 *Douglas V. Fant
 Law Offices of Douglas V. Fant
 8 3655 W. Anthem Dr.
 Suite A-109 PMB 411
 9 Anthem, AZ 85086
 10 *Dan Austin
 Comverge, Inc.
 11 6509 W. Frye Road, Suite 4
 Chandler, AZ 85226
 12
 Jim Nelson
 13 12621 N. 17th Place
 Phoenix, AZ 85022
 14
 *Michael W. Patten, Esq.
 15 *Laura E. Sixkiller, Esq.
 *J. Matthew Derstine, Esq.
 16 Roshka, DeWulf & Patten, PLC
 400 East Van Buren Street
 17 Suite 800
 Phoenix, Arizona 85004
 18
 *Michelle Livengood, Esq.
 19 UniSource Energy Services
 One South Church Street, Suite 200
 20 Tucson, Arizona 85702
 21 *Timothy M. Hogan
 Arizona Center for Law in the
 22 Public Interest
 202 E. McDowell Road, Suite 153
 23 Phoenix, AZ 85004
 24

*Jeff Schlegel
 SWEEP Arizona Representative
 1167 W. Samalayuca Dr.
 Tucson, AZ 85704-3224
 *David Berry
 Western Resource Advocates
 P. O. Box 1064
 Scottsdale, AZ 85252-1064
 *Eric C. Guidry
 Western Resource Advocates
 2260 Baseline Road, Suite 200
 Boulder, Colorado 80302
 Tracy Spoon, Executive Director
 Sun City Taxpayers Association
 12630 N. 103rd Avenue, Suite 144
 Sun City, AZ 85351
 *Walter W. Meek
 Arizona Utility Investors Association
 2100 N. Central Avenue, Suite 210
 Phoenix, Arizona 85004
 *The Kroger Co.
 1014 Vine Street, G-07
 Cincinnati, Ohio 45202
 *Michael L. Kurtz, Esq.
 *Kurt J. Boehm, Esq.
 Boehm, Kurtz & Lowry
 36 East Seventh Street, Suite 1510
 Cincinnati, Ohio 45202
 *Robert W. Geake
 Vice President & General Counsel
 Arizona Water Company
 P. O. Box 29006
 Phoenix, AZ 85038-9006
 *Donna M. Bronski
 Deputy City Attorney
 3939 N. Drinkwater Blvd.
 Scottsdale, AZ 85251

1 *C. Webb Crockett
 *Patrick J. Black
 2 Fennemore Craig
 3003 N. Central Avenue, Suite 2600
 3 Phoenix, AZ 85012-2913
 4 *Greg Patterson, Director
 Arizona Competitive Power Alliance
 5 916 West Adams, Suite 3
 Phoenix, AZ 85007
 6 George Bien-Willner
 7 3641 N. 39th Avenue
 Phoenix, AZ 85014
 8 *Lawrence V. Robertson, Jr.
 9 Munger Chadwick
 P. O. Box 1448
 10 Tubac, AZ 85646
 11 *Lieutenant Colonel Karen S. White
 Chief, Air Force Utility Litigation Team
 12 AFLSA/JACL-ULT
 13 139 Barnes Drive
 Tyndall AFB, FL 32403
 14 *Sean Seitz, President
 Arizona Solar Energy
 15 Industries Association
 3008 N. Civic Center Plaza
 16 Scottsdale, Arizona 85251
 17 *Michael M. Grant
 Gallagher & Kennedy, P.A.
 18 2575 East Camelback Road
 Phoenix, Arizona 85016-9225
 19 *Jay I. Moyes, Esq.
 20 Moyes Storey Ltd.
 1850 N. Central Avenue, Suite 1100
 21 Phoenix, AZ 85004
 22 *Kenneth R. Saline, P. E.
 K.R. Saline & Assoc., PLC
 23 160 N. Pasadena, Suite 101
 Mesa, AZ 85201
 24

*Andrew W. Bettwy
 *Karen S. Haller
 Assistants General Counsel
 Legal Affairs Department
 Southwest Gas Corporation
 5241 Spring Mountain Road
 Las Vegas, Nevada 89150
 *Debra S. Jacobson
 Director
 Government & State Regulatory
 Affairs
 Southwest Gas Corporation
 5241 Spring Mountain Road
 Las Vegas, Nevada 89150
 *Amanda Ormond
 Interwest Energy Alliance
 7650 S. McClintock
 Suite 103-282
 Tempe, AZ 85284
 David C. Kennedy
 Attorney at Law
 818 E. Osborn Road
 Suite 103
 Phoenix, Arizona 85014
 Joseph Knauer, President
 Jewish Community of Sedona
 100 Meadowlark Drive
 P. O. Box 10242
 Sedona, AZ 86339
 Tammie Woody
 10825 W. Laurie Lane
 Peoria, AZ 85345
 *Jon Poston
 AARP Electric Rate Project
 6733 East Dale Lane
 Cave Creek, AZ 85331

1 *Coralette Hannon
2 AARP Government Relations &
3 Advocacy
4 6705 Reedy Creek Road
5 Charlotte, NC 282215

6 Michael F. Healy
7 Morgan, Lewis & Bockius
8 1111 Pennsylvania Avenue, NW
9 Washington, DC 20004

10 *Gary L. Nakarado
11 24657 Foothills Drive N
12 Golden, CO 80401

13 Chairman Hatch-Miller
14 Arizona Corporation Commission

15 Dean Miller
16 Aide to Chairman Hatch-Miller

17 Commissioner Mundell
18 Arizona Corporation Commission

19 Adam Stafford
20 Aide to Commissioner Mundell

21 Commissioner Gleason
22 Arizona Corporation Commission

23 Ken Rozen
24 Aide to Commissioner Gleason

Commissioner Mayes
Arizona Corporation Commission

Matthew Derr
Aide to Commissioner Mayes

Commissioner Wong
Arizona Corporation Commission

Eric Grosneger
Aide to Commissioner Wong

By Ernestine Gamble
Ernestine Gamble
Secretary to Scott Wakefield

**SUMMARY OF TESTIMONY GIVEN BY
J. RICHARD HORNBY
ON BEHALF OF THE
RESIDENTIAL UTILITY CONSUMER OFFICE**

My testimony addresses three issues: the Company's hedging strategy, the updated base fuel rate proposed by APS witness Ewen in his Rebuttal Testimony and the alternative PSA proposal presented in the Direct Testimony of Staff witness Antonuk.

My review of the Company's hedging strategy was based upon the Direct Testimony of its witnesses and their responses to information requests. My major conclusions from that review are that:

- the primary purpose of the hedging program is to stabilize the prices that APS pays for its natural gas and purchased power. As such it is misleading to measure its performance or benefits in terms of its savings, or losses, relative to market prices for natural gas and purchased power at the time of delivery;
- stabilization of natural gas and purchased power prices, in and of itself, is not a major benefit to APS ratepayers. While ratepayers do see a benefit, it is a smaller benefit than that seen by APS because the portion of retail rates stabilized through the hedging program is small relative to total retail rates.
- the detailed design of the APS hedging program does not appear to be based upon quantitative studies or analyses since APS did not provide any in response to discovery or in their Rebuttal Testimony; and
- APS has not presented a corresponding explicit strategy to minimize its natural gas and purchased power costs. APS does minimize its natural gas and purchased power costs in the short-term, by determining the most economic mix of each resource to acquire and hold under its hedging strategy. However APS has not provided a plan for minimizing those costs, and its other energy and capacity costs, in the long-term.

Based upon those conclusions I have two major recommendations. One is that the Arizona Corporation Commission require APS to measure the performance of its hedging

program in terms of the stability of its natural gas and purchased power prices. The other is for the Commission to require APS to develop a strategy to minimize its natural gas and purchased power costs, in the context of minimizing its overall costs, and balance that cost minimization goal with its price stabilization goal.

My second issue is the new, higher Base Fuel Recovery Amount of 3.3112 cents/kwh that Mr. Ewen proposed in his Rebuttal Testimony. This amount is based upon a new set of proposed adjustments through 2007 as well as the Company's withdrawal of its hedging gains/losses proposal. I recommend that the Commission limit the Base Fuel Recovery Amount to 3.1202 cents/kwh, which is the original amount APS requested adjusted for withdrawal of the proposed sharing of hedge gains and losses. By proposing a new Base Fuel Recovery Amount based upon a 2007 Pro Forma APS has moved the reference point from 2006 to 2007 and have done so late in the proceeding leaving intervenors essentially no time to review it, file discovery and analyze the discovery responses prior to filing surrebuttal. Had APS been seriously concerned about potential revenue shortfalls and fuel deferrals in 2007 if its Base Fuel Recovery Amount was set according to its initial 2006 pro forma, then I would have expected it to have raised this concern in its Direct Testimony or by early July at the latest.

My third issue is the potential move to a prospective or forward-looking PSA charge discussed in the Direct Testimony of Staff witness Antonuk. I consider such a change to be premature and do not support it. The existing PSA system was established after extensive deliberations and has only been in effect a short time. It should be allowed further time to prove itself. In addition, introducing a prospective charge raises important issues that would need to be reviewed and discussed.

**REDACTED SUMMARY OF TESTIMONY GIVEN BY
DAVID A. SCHLISSEL
ON BEHALF OF THE
RESIDENTIAL UTILITY CONSUMER OFFICE**

I. DIRECT TESTIMONY

My Direct Testimony addressed two issues: First, whether APS' acquisition of the Sundance Generating Station was prudent. Second, whether the amounts that APS is requesting for Operating & Maintenance expenditures ("O&M") for the PWEC Units and the Sundance Plant are reasonable.

With regard to the first issue, I have concluded that APS' acquisition of the Sundance Generating Station was prudent. This conclusion was based on the following findings:

1. APS shows a need for additional capacity.
2. The acquisition of the CT capacity at Sundance, along with the Company's existing nuclear, coal and combined cycle capacity, gives APS flexibility in meeting peak demands.
3. The process that APS used to select the Sundance Plant appears to have been thorough and reasonable.
4. The price of the Sundance Plant is reasonable compared to the other available alternatives.
5. Economic analyses suggest that the acquisition of the Sundance Plant will produce net economic benefits compared to the other available alternatives.

With regard to the second issue, I have concluded that APS' requested PWEC Unit O&M is unreasonably high and should be reduced by at least \$5,767,852 and that APS' requested Sundance Plant O&M also is unreasonably high and should be reduced by at [REDACTED].

In particular, there are several flaws that lead APS to overinflate the amount of required PWEC Unit O&M

1. APS began with what are designated as the actual PWEC 2004 O&M expenditures instead of the Units' O&M expenditures for the October 2004-September 2005 test year.
2. APS makes a pro forma adjustment for variable O&M that began with the PWEC Units' actual 2004 generation and reflected projected generation levels from APS' 2005 Long Range Forecast that are substantially [REDACTED] than the more recent 2006 rate case generation forecasts.

As I show in Exhibit DAS-2, when I made corrections to adjust for these flaws, using APS' own methodology the level of required PWEC Unit O&M was reduced by at least \$5,767,852. This conclusion is conservative because it is unclear whether the actual PWEC 2004 O&M expenditure figures provided by the Company in its workpapers and

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data responses reflect the subtraction of the APS-PWEC affiliate charges for auxiliary power and common facilities.

APS' calculation of requested Sundance Plant variable O&M also is flawed. As shown in APS' workpapers, the Company's requested annual level of Sundance O&M includes a \$2,750,000 adjustment for variable maintenance costs. This adjustment is based on the assumption that future generation at Sundance will average 630,000 MWH per year.

However, However, APS' 2006 Rate Case forecasts project that the Sundance Plant will generate only an average of [REDACTED] MWH each year during the three year period 2006-2008. Replacing the estimated 630,000 MWH used to calculate APS's requested variable O&M by this [REDACTED] MWH figure, reduces the variable O&M adjustment by \$1,121,825.

II. SURREBUTTAL TESTIMONY

My surrebuttal testimony responded to the claim of APS witness Ewen that my proposed PWEC O&M adjustment is inconsistent with the ACC Staff's consultants which found that "O&M expenditure patterns [to be] consistent with operation requirements." The Staff consultant review referenced by Mr. Ewen examined the historic O&M expenditures at APS' fossil station and not the Company's projected future levels of expenditures. In contrast, my proposed adjustments did not address at all the reasonableness of historic O&M expenditures. Instead, my adjustments were focused (1) on making the Company's projected normalized variable O&M rate case requests for the PWEC and Sundance facilities consistent with APS' most recent projections of the expected generation of the those units during the years 2006-2008 and (2) ensuring that the Company's requested O&M reflect the actual levels of 2004 expenditures at the PWEC units as reflected in APS' response to Data Requests UTI-11-329.1 As I noted in my direct testimony, APS' projected variable O&M were based on the Company's 2005 Long Range Forecast and not on the more recent 2006 Rate Case Forecasts.

Consequently, contrary to what Mr. Ewen has testified, the Staff consultant's conclusions about historic O&M expenditure levels do not conflict in any way with my proposed adjustment of APS' forecast future variable O&M expenses at the PWEC and Sundance facilities.

¹ Direct Testimony of David A. Schlissel, at page 4, line 11, through page 6, line 10.